

**Budget Bill for 2021 – Feasible but Very Challenging**

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This Monday (August 31), the government presented the budget bill (PLOA) for 2021. The proposal came without major surprises, showing little room for maneuvering in the budgetary framework given the limits imposed by the main fiscal rules in place, especially the constitutional spending cap. Even so, we think the proposal seems feasible for the current conditions of current policies. The great source of uncertainty is the possibility of creating a new income transfer program (already known as *Renda Brasil*), details of which have not yet been presented nor contemplated in PLOA 2021. This new program aims to replace (but with even greater reach) the *Bolsa Família* program, whose budget was increased to BRL35 billion in 2021. *Renda Brasil* will create permanent expenses for the coming years, and if not offset by reductions in other expenses, it would be incompatible with the spending cap limit, since its compliance would imply a partial shutdown of the federal public administration.

Given the lack of a formal primary deficit target, the primary result of 2021 will depend on the cyclical behavior of revenues, with the submission of expenses compliant with the constitutional spending cap as a limiting factor. The government's initial forecast is a deficit of BRL234 billion, not far from our estimate (BRL249 billion). In addition, to fulfill another fiscal rule, called 'Golden Rule' – that establishes that the government can only get into debt to finance capital expenses or refinance public debt – the Congress would have to approve an additional credit of BRL453.7 billion, well above the BRL343.6 billion approved in 2020.

These figures reinforce the notion of limited space for new permanent expenses. Discretionary expenses (investments and administrative costs) are predicted to approach the lowest level in history, around BRL108 billion. This amount is close to our estimate of the minimum limit for the good functioning of the public sector administration (around BRL100 billion).

When opening the accounts, we estimate that central government revenues will be below forecast (see Table 1). The main difference stems from the 2020 revenue estimates, considering that we project a GDP contraction of 6.4% while the government forecasts a decrease of 4.7%. Despite our GDP forecast for 2021 (+4.2%) being higher than the government's (+ 3.2%), the estimated revenue in our 2021 forecast is still BRL44 billion below the official forecast. The opening of the numbers shows the biggest difference is in the line "Administered by the Federal Revenue," which is more dependent on the cycles of economic activity.

In terms of expenses, the values we project are closer to the official figures. Without considering changes in the spending ceiling, expenses tend to be close to BRL1.5 trillion in both scenarios. The details show little divergence in discretionary expenses, about BRL110 billion both in our scenario and in the official projection. The biggest difference is due to personnel expenses, where the government's estimate is BRL12 billion higher than ours, probably incorporating some additional degree of conservatism.

In general, we believe that next year's primary deficit will depend more on the evolution of revenues than on the spending scenario, whose variability tends to be limited due to the high proportion of mandatory expenses and the proximity to the constitutional spending cap. It is important to note that revenues may still be more impacted by an eventual tax amnesty program ("Refis" type), possibly focused on tax exemptions granted during the pandemic. In addition, the uncertainty is great about the strength of the resumption of activity in the next year, and this factor should greatly influence the evolution of revenues in 2021.

In our opinion, after the Executive's proposal, debates over the 2021 budget and post-pandemic policies are likely to intensify in the coming weeks. And the market will be aware of the conditions for maintaining the effectiveness of the current fiscal regime and the capacity to fully implement the constitutional spending ceiling – which we see as the main anchor for long-term macroeconomic stability expectations in Brazil.

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Table 1. Primary Result	Gov. Report <sup>1</sup>				PLOA <sup>2</sup>		
	Santander		Δ*	Santander		Δ	

BRLbillions	2019	2020E			2021E		
Total Revenues	1,635.1	1,456.2	1,390.1	66.1	1,560.1	1,516.1	44.0
<i>Transfers to Regional Governments</i>	288.3	260.9	258.1	2.8	276.9	274.8	2.1
Net Revenues	1,346.8	1,195.3	1,132.0	63.3	1,283.2	1,241.3	41.9
Total Expenses	1,441.8	1,982.8	1,977.3	5.5	1,516.8	1,491.0	25.8
<b>Primary Balance</b>	<b>-95.1</b>	<b>-787.5</b>	<b>-845.3</b>	<b>57.8</b>	<b>-233.6</b>	<b>-249.8</b>	<b>16.2</b>

Revenues							
<b>Total Revenues</b>	<b>1,635.10</b>	<b>1,456.2</b>	<b>1,390.1</b>	<b>66.1</b>	<b>1,560.1</b>	<b>1,516.1</b>	<b>44.0</b>
Administered by the Federal Revenue	946.0	891.2	842.0	49.2	975.0	917.8	57.2
Administered by the INSS (Pensions)	413.3	401.0	390.6	10.4	417.5	409.3	8.2
Others	275.7	163.9	157.5	6.4	167.6	188.9	-21.4

Expenses							
<b>Total Expenses</b>	<b>1,441.85</b>	<b>1,982.8</b>	<b>1,977.3</b>	<b>5.5</b>	<b>1,516.8</b>	<b>1,491.0</b>	<b>25.8</b>
Social security benefits	626.5	677.2	674.8	2.4	704.4	701.7	2.7
Personnel and social charges	313.1	324.8	321.9	2.9	337.3	325.1	12.3
Other Compulsory Expenses	382.6	865.8	878.7	-12.9	366.6	357.0	9.6
Discretionary	119.7	115.0	102.0	13.0	108.4	107.2	1.2

<sup>1</sup> Primary Income and Expenses Evaluation Report - 3rd bimester of 2020

<sup>2</sup> Budget Bill proposal

\* Variation between government estimates and our forecasts

Sources: Ministry of Economy and Santander



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